

~~SECRET~~

Chief, D/A

Chief, D/E

CMFP Drafting Group on Economic Defense Policy Review, Staff Study #18, "Cancellation and Reinstatement of Soviet Contracts with the U.K."

Attached is copy of subject report which was received on 24 June 55 at 5:00 P.M. for coordination in OEN.

The Dodge Council Drafting Group is scheduled to meet in almost continual session to review the Staff Studies as rapidly as they become available.

In order to be useful, review by your interested Branches should be made almost immediately.

Comments may be sent or telephoned to [REDACTED] Room 312 Central Building, Extension 2850, as soon as possible.

25X1A9a

25X1A

1 Encl.

Staff Study #18

D/E/WR:DJ:jws (27 June 55)

Distribution:

0 & 1 - Addressee

1 - CM/D/E

3 - E/C

State Dept. declassification instructions on file

~~SECRET~~

Rec'd 5:00 PM
June 55
D/E file
copy

SECRET

CFEP DRAFTING GROUP
ECONOMIC DEFENSE POLICY REVIEW

Staff Study No. 18
Draft of June 22, 1955

Cancellation and Reinstatement of Soviet Contracts with the U.K.

This draft of Staff Study No. 18, "Cancellation and Reinstatement of Soviet Contracts with the U.K.", is transmitted for your use in connection with the work of the CFEP Drafting Group on Economic Defense Policy Review.

In compliance with the request of the Chairman of the Drafting Group, the Executive Secretary, EDAC, is providing reproduction and distribution facilities as a service to further the work of the CFEP Drafting Group.

Irving I. Kramer
Executive Secretary

Distribution:
CFEP Drafting Group

SECRET

CFEP DRAFTING GROUP

ECONOMIC DEFENSE POLICY REVIEW

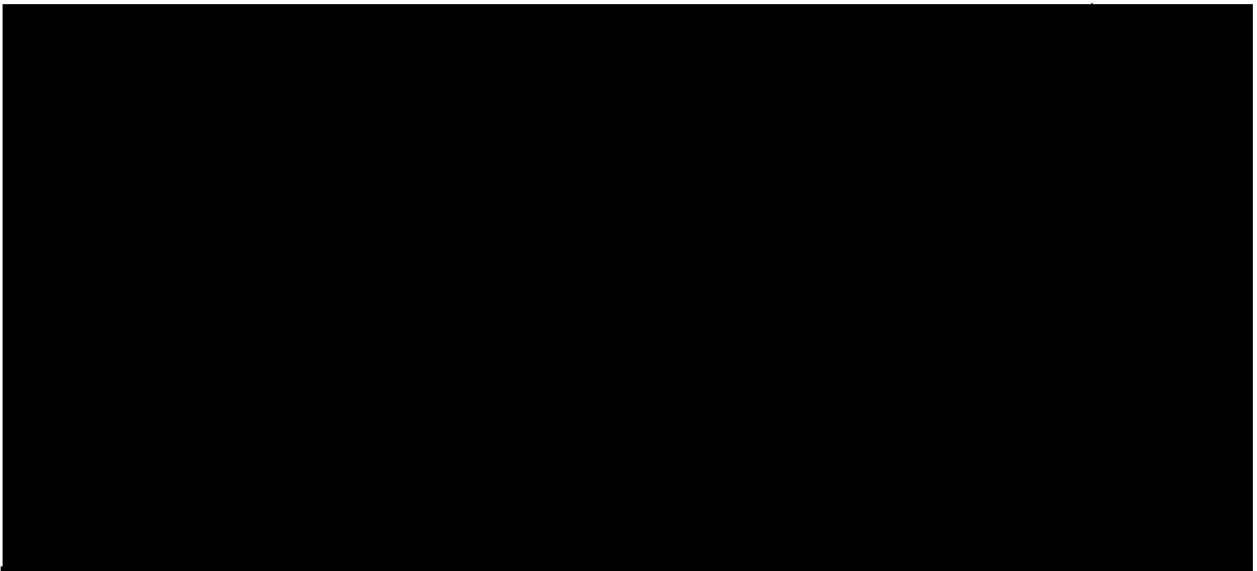
Staff Study No. 18
(Draft State/OIR)
June 22, 1955

Cancellation and Reinstatement of Soviet Contracts with the UK

During January, February, and March 1955 it was reported that the Soviet Union was attempting to cancel or modify a number of its outstanding contracts with British business firms. During April and May some, but not all, of these contracts were reinstated in their original form or in some form midway between the original and the attempted modification. These attempted cancellations, appearing after the large Soviet orders placed in the UK during 1954 and the generally conciliatory approach to British traders, seemed to many observers a significant shift in USSR trade policy. The apparent reversal of these actions, by reinstatement, raises the question of Soviet motivation.

25X6

Background



It is estimated that Soviet purchase contracts outstanding in

25X6

SECRET

- 2 -

25X6

Great Britain in early 1955 were about \$100 million, much of this for delivery over a two-year period. (This figure excludes a number of large Soviet orders for items retained on the revised embargo list for which export licenses have been denied.)

Almost all of the contracts which the Soviets attempted to cancel or modify were for machinery and electrical equipment, the principal exception being a £ 250,000 order for rayon yarn. These ^{items} machinery products included some which were clearly to be used for production of consumer goods, such as textile machines, milk bottling machines, a dairy plant, etc. The list also includes electrical items not necessarily related to the output of consumer goods, and some basic machine tools with potential military uses. Most significant among the latter was the order for large horizontal boring mills, elaborate and expensive machines which required that their supplier, William Asquith Ltd., build a new plant in order to fill the contract. The two largest cancellations were for textile machinery and diesel generators.

Of the attempted Soviet modifications, two cases involved complete cancellation, eight involved cancellation of part of the contract, and two more were concerned with delaying delivery dates. Final settlement has been reached in about half of these cases. Some firms have accepted a reduced contract, and others have been able to reinstate contracts in their original form.

25X6

In some cases the payment by the USSR of penalties for cancellation, as provided in the contracts, presented a problem; the Soviet trade agencies attempted to find small deviations on the part of UK firms from terms of the contracts in order to obtain a loophole to avoid penalty.

SECRET

(US OFFICIALS ONLY)

25X6

- 3 -

payments, but did not always succeed. Many of these contracts were covered by a UK Government export guarantee which would compensate the British firms for losses occasioned by cancellations.

There have been a few reports of Soviet cancellation of contracts with other countries in Western Europe, but not on the scale that was found in the UK. A French contract for rayon yarn was cancelled, as was a West German contract for 30 fishing trawlers, and there were some instances of delay or withdrawal of Soviet orders prior to a final conclusion of contracts. In addition, several countries encountered difficulties in negotiating with the USSR in the first quarter of 1955, notably the Swedes who had the impression that Soviet negotiators were negative and unsure of what their superiors in Moscow wanted them to do.

25X6

Actual Soviet trade with Western Europe from January through March 1955 did not show striking differences from trade in the same period of 1954, though some shifts occurred. Total Soviet imports were nine percent higher, while exports were 25 percent lower. Trade with the UK in both directions was higher, and with Finland lower, than in 1954; these are the two largest trade partners. The largest shifts were a decrease in trade with Denmark, a drop in Soviet imports from France (exports were about the same), and an increase in imports from Italy and Sweden (exports declined in both cases). It is difficult to see any trend in Soviet trade policy revealed in these figures.

Causes

Various explanations have been offered for Soviet efforts to cancel contracts in early 1955. Any explanation of this action must ^{take into} ~~now~~ account [?] for its subsequent reversal.

SECRET
(US OFFICIALS ONLY)

a) Many of the discussions in Britain have centered around a shift in Soviet internal economic policy, following the resignation of Malenkov, in which the earlier priority given to consumer goods was decreased in favor of heavy industry. The objections to this explanation are, first, that it does not explain reinstatement of contracts, and second that the products involved were not exclusively related to consumer goods but included a large proportion of goods useful for the growth of heavy industry or defense (almost all were capital goods of some sort). In any case there is some question as to the nature of a 1955 shift in internal Soviet policy.

b) It has also been stated that the USSR wished to conserve foreign exchange and was cutting down on its outstanding obligations which happened to be concentrated in the UK at the time. It is true that the USSR had incurred a large deficit in its 1954 trade with the free world, and it appears that Soviet sterling reserves were in fact at a low point in early 1955. On the other hand, the Soviet trade deficit had been built up in the first half of 1954 only, since exports exceeded imports during the second half of the year, so that the condition was not a new one in early 1955. Moreover, the 1954 deficit had been made possible by sales of gold in 1953-54, and there is no apparent reason why these sales could not have been repeated in early 1955. Not until June 1955 were large scale sales of Soviet gold to the UK reported.

c) Some observers, particularly in the French Foreign Office, saw in these maneuvers an attempt by the USSR to use trade as a form of pressure to hinder ratification of the London-Paris accords on the re-armament of West Germany. British businessmen and the Board of Trade had been told on several occasions by Soviet trade officials, both in

SECRET

- 5 -

London and Moscow, that trade was connected with ratification. But it is not clear why this effort, if it was intended as a form of political pressure, should have been expended in the UK, where ratification had seemed probable as early as October 1954, rather than in continental countries where the issue was more in doubt.

d) An alternative explanation, not widely discussed, is that with the resignation of Malenkov and Mikoyan a period of confusion began in the lower echelons of the Soviet Ministry of Foreign Trade (as revealed in the Swedish negotiations). Trade officials, fearing a general purge, may have tried to outdo one another in getting "tough" with the West. Later, as it became clear that personnel shifts and policy changes were much less than had been anticipated, the previous actions had to be rescinded.

e) Possible explanations for the reinstatement of contracts include an increased emphasis by the Soviet Union on conciliatory gestures toward the West as prospects for a "big-4" meeting improved, combined with a delayed realization of the damage which contract cancellations were doing to the relatively good commercial reputation of the USSR in an important market.

It is possible that all these causes were contributory. But because of temporary nature of the phenomenon it is unlikely that it represents or foreshadows a major change in Soviet trade policy.

SECRET

(US OFFICIALS ONLY)